VZCZCXRO4826 RR RUEHLN RUEHSK RUEHVK RUEHYG DE RUEHDBU #0241/01 0581300 ZNR UUUUU ZZH R 271300Z FEB 09 FM AMEMBASSY DUSHANBE TO RUEHC/SECSTATE WASHDC 0095 INFO RUCNCIS/CIS COLLECTIVE RUEHIL/AMEMBASSY ISLAMABAD 0010 RUEHBUL/AMEMBASSY KABUL 0025 RUEHNE/AMEMBASSY NEW DELHI 0020 RUEHBJ/AMEMBASSY BEIJING 0010 RUEAIIA/CIA WASHDC RUCPDOC/DEPT OF COMMERCE WASHINGTON DC RUEATRS/DEPT OF TREASURY WASHINGTON DC RHEHAAA/NSC WASHINGTON DC RUEHDBU/AMEMBASSY DUSHANBE 0128

UNCLAS SECTION 01 OF 03 DUSHANBE 000241

SENSITIVE SIPDIS

DEPARTMENT FOR SCA/CEN

E.O. 12958: N/A

TAGS: EFIN ECON ETRD PGOV ELAB TI

SUBJECT: TAJIKISTAN'S ECONOMY IN DIRE CONDITION, INTERNATIONAL

FINANCIAL INSTITUTIONS SAY

REF: A: 08 DUSHANBE 1502, B: 08 DUSHANBE 1548

DUSHANBE 00000241 001.2 OF 003

11. (U) Summary: The International Monetary Fund (IMF) and the European Bank for Reconstruction and Development (EBRD) are predicting a very difficult year ahead for Tajikistan as a result of the global financial crisis. Economists at both institutions say the situation is far worse than they had predicted even a month ago. It is expected that the major impact on the Tajik economy will come from a steep drop in remittances from Tajiks working abroad, especially in Russia. Remittances, which equaled over half of Tajikistan's GDP last year, are a lifeline for this poor economy. But January figures were 22% lower than the previous year, the first such drop in six years of recordkeeping. The IMF predicts GDP growth of 3% this year, but cautions that this is "optimistic." The EBRD initially predicted 5%, but said the figure will be revised downward. Economists at both organizations said the economy will likely get much worse before it gets better, and Tajikistan may require significant support to avoid serious hardship. The IMF mission here said the results of the IMF-mandated audit of the Central Bank will be made public soon, and following this they will recommend renewed a Poverty Reduction and Growth Facility (PRGF) for Tajikistan at the April meeting of the IMF's End summary. board.

IMF, EBRD Urge Support for Fragile Tajik Economy

 $\P2$. (U) The IMF briefed the international donor community on the health of Tajikistan's economy on February 18. Over the course of the previous two weeks, an IMF team lead by Mission Chief for Tajikistan Axel Schimmelpfennig had been in Dushanbe to assess the country's macroeconomic conditions, meet with government officials, and make recommendations about the future. Schimmelpfennig announced that, based on the team's findings, they are recommending a resumption of assistance to Tajikistan under the IMF's low-interest lending program for low-income countries, the Poverty Reduction and Growth Facility (PRGF). (IMF assistance to Tajikistan was suspended last year as a result of National Bank misreporting about loans it had underwritten to cotton sector financers. IMF officials report that the Bank has been meeting the loan repayments required for resumption of assistance, and they are satisfied with Tajikistan's macroeconomic policy.) Schimmelpfennig said his team will recommend a PRGF in the amount of \$120 million, with much of the assistance front-loaded in order to help Tajikistan

cope with the financial crisis. The proposal will be taken up by the IMF's board in Washington at the beginning of April.

¶3. (U) In a separate presentation two days later, the EBRD unveiled its transition report for 2008, detailing economic conditions and country performance in the Eurasian region. EBRD Principal Economist Rika Ishii, based in London, was similarly pessimistic about the state of the Tajik economy, saying that the situation here is considerably worse than she had predicted just a month ago. EBRD country director Mathieu Le Blan said that the Bank intends to make some 50 million Euros available to Tajikistan this year in assistance.

What a Difference Two Months Make

- 14. (U) The majority of Axel Schimmelpfennig's presentation was devoted to a dour appraisal of Tajikistan's economic climate over the coming year. His tone was markedly gloomier than it was during his last visit two months ago (ref A). During that visit he said Tajikistan was likely to be insulated from the full brunt of the economic crisis due to the isolation of its banking sector and the presumed resilience of remittance flows. This time, however, he acknowledged that the crisis was already having a very negative effect on the country, and there were few domestic resources available to respond to it. He noted that 44% of domestic industries are not running at all right now due to insufficient power.
- 15. (U) Schimmelpfennig said the IMF was now predicting GDP growth of 3% for Tajikistan in 2009 -- compared to its earlier projection of 5-6% -- "if all goes well." But, he said, all was not likely to go well, particularly given new projections that Russia's economy will contract by 1% over the coming year. Given Tajikistan's dependence on Russia as its primary source of imports and remittances, negative growth in the Russian economy will almost certainly have a significant impact here. EBRD's

DUSHANBE 00000241 002.2 OF 003

Ishii said that the Russian Ministry of Finance had recently released its own projection of a 2.2% contraction in the Russian economy. In light of this, the projection she had made at the end of January that Tajikistan's economy would grow by 5% this year -- based chiefly on the relatively mild winter -- would have to be significantly downwardly revised. She added anecdotally that even over the course of the two days she had spent in Tajikistan on this visit, it was clear that the situation is much worse than she had imagined from London.

The Rose-Colored Glasses are Off on Remittances

- 16. (U) The major impact of the global financial crisis on the Tajik economy will be felt through a decline in remittances. Since 2003, when the IMF began collecting data, remittances through the banking system have grown substantially year after year, reaching \$2.67 billion in 2008 -- equivalent to 52% of Tajikistan's GDP, the highest percentage of any country in the world. In January of this year, however, for the first time in six years remittances declined year-on-year, dropping 22% from January 2008. The IMF forecasts that remittances over the course of 2009 will be 30% lower than 2008, but Schimmelpfennig once again cautioned that even this figure may be optimistic, given credible projections he has seen of a 50% drop. The EBRD also predicts that remittances will decline steeply, but they did not make a specific prediction.
- 17. (U) The IMF appears to have adopted a different paradigm since its earlier briefing in December. Even as the financial crisis was gathering steam, IMF and World Bank officials were predicting that remittances would prove resilient to economic shocks. Some of their confidence was based on economic research, including work done by World Bank remittance expert Dilip Ratha, arguing that remittances are very "supply dependent" -- i.e., that overseas guestworkers will do everything possible to continue sending money back home, including moving to a new location or country, accepting lower-status or lower-paying work, or even cutting back on their

own expenditures on food and housing. The new IMF and EBRD projections appear to eschew this earlier logic, however.

¶8. (U) Ishii cautioned, however, that we should avoid drawing conclusions from one month in isolation. She noted that January 2008 remittance figures were particularly high as a result of last winter's food crisis, when overseas workers made efforts to send home as much money as possible to help their families. She said she has also heard reports that more people may be hand-carrying remittances home rather than sending them through banks, out of concern about the stability of the Tajik banking sector. Both factors would result in deflated January 2009 figures. A clearer picture would emerge, she said, when data from February and March are known. Schimmelpfennig said that a side effect of continued decline in remittances would be the return of a significant amount of overseas workers. If this happened, the country would have less money with which to feed more mouths — a situation that had the potential to spiral downward.

Somoni Expected to Slide South

 $\P9$. (U) Both the EBRD and IMF experts said they expected the Tajik somoni to continue to decline against the dollar. (Note: In the last few months the somoni has dropped from 3.4 to as much as 3.9 to the dollar. The official rate is currently 3.8. Since the currency floats freely, unofficial rates do not vary much from the official rate, although they are usually a tenth of a somoni higher. End note.) Schimmelpfennig said that there is almost nothing the National Bank of Tajikistan can do to halt the slide of the somoni, given its relatively small reserves and the sheer size of the macroeconomic forces it is up against. Even if it had the ability to protect the currency, however, he strongly advised the Bank to let the slide continue, acting only to ensure that the decline was smooth. While the decline hurt imports, it nevertheless boosted domestic production. He was reluctant to predict where the somoni would be trading at year's end, but said he would not be surprised if the "real effective exchange rate" against a basket of world currencies would likely drop by 10% or 20%.

110. (U) Schimmelpfennig said that as a result of worsening DUSHANBE 00000241 003.2 OF 003

macroeconomic conditions and declining revenues, the external financing gap for the country's budget would be \$135 million this year. He was recommending that the IMF contribute \$51 million toward closing that gap, with other donors offering \$74 million in direct budget support. The IMF also predicts a 7% drop in trade, which some donors thought was optimistic.

Bright Spots? Not Many

 $\P11$. (U) Schimmelpfennig said that there are a few potential bright spots in the Tajik economy. One was that domestic non-cotton agricultural production may receive a boost due to plummeting world cotton prices and the increased cost of food imports. A great deal of Tajik food comes from Russia; while the somoni has held relatively stable against the ruble, its decline against other world currencies may make it more difficult to purchase imports. Schimmelpfennig said he has already seen some limited evidence that government leaders recognized the importance of diversifying the agricultural sector, and this was an issue the IMF would follow up on. He added that there has also been some positive inertia in the domestic construction sector, even $\bar{\text{in}}$ Dushanbe, which appears not to have slowed much due to the financial crisis. As the crisis prolongs, however, this may change. (He expressed some surprise that the construction of the Somoni Hotel, financed by a Turkish firm, is continuing around the clock.) He added that inflation was expected to come in at 12-13% in 2009,

Audit Results Expected Soon

111. (SBU) During a question-and-answer session after the IMF presentation, Schimmelpfennig gave a status update on three

major audits commissioned in the wake of the misreporting scandal. The audit of the National Bank had been completed, and he expected that its key findings would be published on the bank's website within the next month. (Note: in an earlier conversation IMF country director Luc Moers told Econoff that the bank, which could use its own discretion in deciding what findings were considered "key," might choose not to make negative conclusions public (ref B). End note.) He said there would be no surprises, although he added -- to some raised eyebrows in the room -- that "the key for everyone will be to take a little bit of a leap of faith in the authorities that everything is on track."

- 112. (SBU) The audit of the Barki Tajik has been completed and should be published soon. The audit of the Talco aluminum company, the nation's largest industry, has still not been conducted. Three firms have submitted bids. Under Tajik law the country is obligated to select the lowest bid, which in this case comes from the "mid-tier" London-based firm Moore Stephens, out of its Moscow office. Schimmelpfennig admitted, however, that he would be much more comfortable if the audit were performed by Big-Four firm Ernst and Young, whose bid was \$150,000\$ higher. He appealed to donors in the audience toconsider providing that funding. (He had assurances from the Tajik government that there would be no problem accepting Ernst and Young provided the gap was met by a donor.)
- 113. (SBU) Comment: Earlier predictions by the IMF, echoed by Tajik Government officials, that Tajikistan was shielded from the global crisis have now gone by the board, and all eyes are on the economic situation in Russia. The next major economic indicator to watch will be how many Tajiks return to Russia to work later in the spring, and how much remittances pick up during that time. Now that Tajikistan has successfully completed the Staff Monitoring Program demanded after the misreporting scandal, which the IMF says has led to some improvements in banking governance and Finance Ministry oversight of state enterprises, the IMF is looking to move forward with the PRGF; it will make a proposal to its board in the first week of April. We would withhold judgement on the advisability of a PGRF until the Central Bank's audit is posted. End Comment. **JACOBSON**